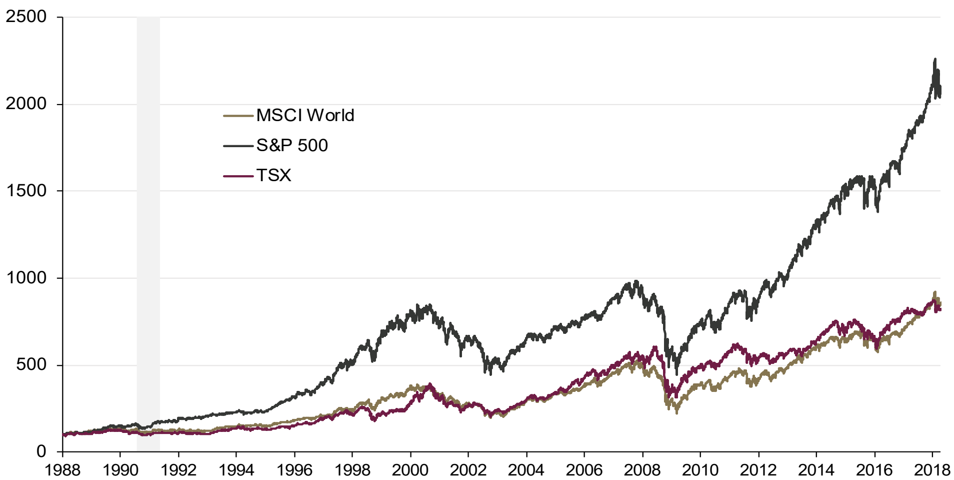
Time In, Not Timing, the Market is the Key to Building Wealth

The recent increase in volatility in global financial markets is the kind of thing that can prompt investors to want to pull their money out of the market and stuff it in their mattress for safe-keeping. For any investor with a longer time horizon, however, such an approach to uncertain near-term market conditions is bad for their wealth.

Equity markets may go through bad weeks, months, or even years, but history has shown that over the longer-run, stock prices rise. Looking at the last 30 calendar years, global stocks have generated positive returns in 22 of those years (73% of the time) and by an annualized gain of 7.4% in Canadian dollar terms. The S&P 500 has had positive performance in 25 of 30 years (83% of the time) with an annualized gain of 10.7%, while the S&P/TSX is up in 21 of these years (70% of the time) with an annualized gain of 7.5%.

Stocks Generate Positive Total Returns in the Long-Run
(indexed in Canadian dollar terms, January 1, 1988 = 100)



Shaded regions represent periods of U.S. recession
Source: Bloomberg, Guardian Capital

Avoiding the worst periods by being able to move out of markets ahead of declines would significantly improve investor performance beyond these index returns. However, this is much easier said than done. While equity markets rise over the long-run, their short-run movements are far more unpredictable. Calling a top or bottom in a market cycle is exceedingly difficult, and doing it with consistency is near impossible. The unfortunate truth is that the public tends to buy the most at the top and the least at the bottom.

Further to this point, one of the most common mistakes investors make is selling at the bottom and turning paper losses into realized ones. Sitting on cash also means that investors find themselves on the sidelines when markets recover, failing to participate in the bulk of a market rebound that historically occurs early (and quickly) following a correction.

Timing the market is a double-edged sword — not only does this require determining when to get out of stocks, but also when to get back in. Even being a day late with respect to rejoining the party can have significant negative performance implications. The focus should be on ensuring you are there for the many good days, more than trying to avoid the few bad days.

Research[1] has shown that as much as 95% of absolute return in the market is accounted for by just 1% of trading days, roughly equivalent to an entire year's performance being driven by just three days. Indeed, as the chart below shows, missing out on just the 10 best days over the near 8,000 trading days spanning the last three decades, reduces annualized returns by a full two percentage points. In other words, $100,000 invested at the beginning of 1988 would be worth 40% less now strictly if those top 10 days were missed.

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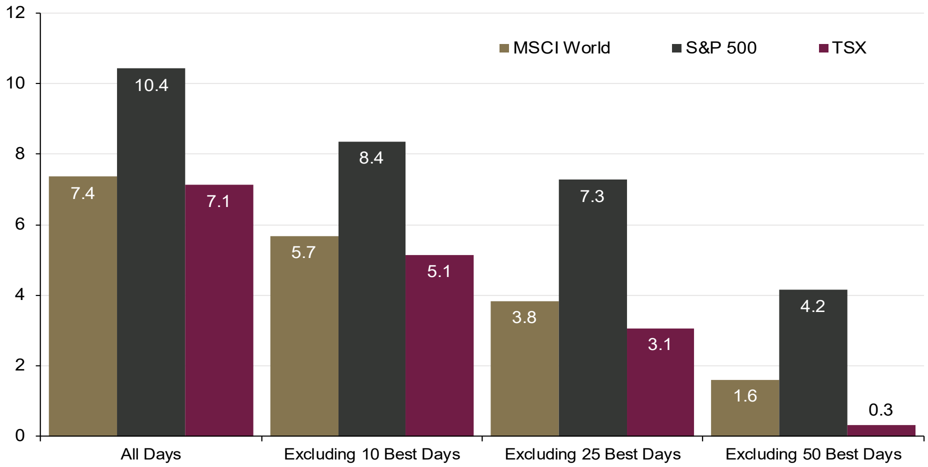
(annualized total return in Canadian dollar terms)



Based on daily data from January 4, 1988 to April 11, 2018
Source: Bloomberg, Guardian Capital

Markets can be volatile and enigmatic, but maintaining a long-term focus and a disciplined approach to investing will pay dividends, both figuratively and literally. The presence of dividends adds the powerful force of compounding to returns, encourages reinvestment even as markets decline, and can help to soften the downside risks to portfolios.

Ultimately, it is "*time in*" rather than "*timing*" the market that is key to long term wealth building.

[1]H. Nejat Seyhun, University of Michigan, *"Stock Market Extremes and Portfolio Performance"* commissioned by Towneley Capital Management, 1994.